



DEPARTMENT OF THE ARMY  
WASHINGTON DC 20310-0200  
20 SEP 2003

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The Honorable Duncan Hunter  
Chairman  
Committee on Armed Services  
United States House of Representatives  
Washington, D.C. 20515

Dear Mr. Chairman:

The Department of Defense Appropriations Act for Fiscal Year 2002 (FY02), Section 8150, states, "\$25,000,000 shall be available to the Secretary of the Army only for the purpose of funding a venture capital investment corporation." The FY02 HAC Report, H.R. 107-298, on page 171, states that, "upon the formation of the corporation, the Secretary of the Army shall submit a report on the formation of the corporation, including a detailed description of the corporation's members of the board, operating procedures, and investment strategies. This report shall also describe measures that the Army will take to develop and implement streamlined acquisition procedures enabling the Army to develop and field technologies identified by the venture capital fund corporation."

Enclosed is the Army's report as required by the House Report 107-298 on the Venture Capital Initiative. Army staff representatives are available to brief the committees at your convenience on the details of the report.

Sincerely,

R. L. Brownlee  
Acting Secretary of the Army

Enclosure

# **REPORT TO CONGRESSIONAL DEFENSE COMMITTEES**

Regarding the

## **Formation and Implementation of the Army Venture Capital Initiative**



August 22, 2003

# **THE ARMY VENTURE CAPITAL INITIATIVE**

## **Reference**

The Department of Defense Appropriations Act, Public Law 107-117, Section 8150, earmarked \$25,000,000 of Army funds for a Venture Capital Investment Corporation (VCIC) established pursuant to Section 2371 of Title 10 of the United States Code. Section 8150 derives these funds from amounts made available to the Army for basic research and applied research. This report answers the VCIC formation reporting requirements of House Report 107-298.

## **Background**

In September of 2002 the U.S. Army Communications Electronics Command (CECOM) issued a Broad Agency Announcement (BAA) requesting proposals to manage the VCIC. By the submission deadline twenty proposals had been received from a broad range of organizations. After a thorough evaluation process, a proposal submitted by Military Commercial Technologies, Inc. (MILCOM) was announced as the winner. MILCOM is a for-profit venture capital company with a good track record and significant experience collaborating with government organizations. MILCOM proposed to incorporate a not-for-profit affiliate, with which it would maintain a formal, but independent relationship. OnPoint Technologies, Inc. has since been established as MILCOM's nonprofit partner. On May 6, 2003 the Army entered into an Other Transaction Agreement with OnPoint to manage venture capital investments funded with Army dollars.

## **Implementation**

**A. Non-profit corporation.** Public Law 107-117, Section 8150 indicates that a nonprofit corporation shall handle the venture capital funds. Accordingly, OnPoint has been organized in accordance with Title 26, United States Code, Section 501(c)(3). Under this form of business organization, the earnings of the organization cannot be paid back to private individuals or shareholders. Instead, a 501(c)(3) organization is required to use any earnings on the tax-exempt purposes for which it was formed. On dissolution of the organization, its remaining assets must be used for one of the exempt purposes or distributed to federal, state or local governments for public purposes.

**B. Contracting Vehicle.** The relationship between the Army and the VCIC is governed by an "Other Transaction" (OT) instrument as defined in Title 10, United States Code, Section 2371. The technical lead for this program is the Natick Soldier Center (NSC), under the Soldier and Biological Chemical Command (SBCCOM), a major subordinate command of the Army Material Command (AMC). Another major subordinate command of the Army Material Command, the US Army Communications and Electronics Command (CECOM) administers the OT for the Army.

**C. VCIC Operating Procedures and Investment Strategies.** OnPoint will invest in a high priority area, soldier power and energy technology where the focus is on lightweight, compact, and rugged, extended life power sources. A parallel commercial demand for such power sources is also likely to be strong, so this a natural dual use technical development area.

Identification of appropriate investments is based on a technology roadmapping process that MILCOM has developed and used previously. This process, conducted periodically, uses an informal team consisting of Army representatives, technologists from industry and government, investment bankers, venture capitalists and MILCOM and OnPoint staff to ascertain power and energy technology applicable to the requirements of the individual soldier. The focus will be aimed at prioritizing and identifying current and future military devices that require significantly improved power and energy sources. The roadmapping process has the additional benefit of providing the MILCOM and OnPoint staff with networks into the Army technology and acquisition base that will ultimately be the Army customers for the technologies developed through this initiative.

Potential investments will be solicited through a variety of mechanisms. Standard methods for the venture capital industry, such as Internet presence, advertisements in targeted publications and networking in the investment and entrepreneurial communities will be primary sources for communicating with potential investees. Additional sources of potential investments will include the spin-off of relevant work in government laboratories, networking with government engineers and scientists and leveraging government innovation programs, such as Small Business Innovation Research (SBIR) contracts and grants. These sources of investment opportunity will be mined to identify individuals, teams and companies with innovative technologies or solutions that could be used to address soldier power and energy requirements and that also have the market potential to provide a significant return on investment over several years.

Under the terms of the OT, MILCOM will manage most of the actual investing activities; identifying potential investments, conducting due diligence, recommending investments, managing the portfolio of investments and managing most of the administrative burdens associated with investing. OnPoint will be more than a passive investor though; approving investments recommended by

MILCOM, managing relations with the Army and insuring that Army goals are pursued as a main part of the investment activities. Both entities are responsible for managing the technology road-mapping process discussed earlier.

For its efforts, MILCOM will be compensated much like any other venture capitalist. It will retain a percentage of any profits. To encourage technology transfer, MILCOM will receive additional compensation when technologies developed through its investments, are integrated into the Army. Because OnPoint is a not for profit organization, earnings on its investments are reinvested. If the fund is successful, OnPoint will become an "evergreen" fund, i.e., self-financing, using the proceeds from earlier investments to finance each new round of investments in technologies of interest to the Army.

Profits remaining after MILCOM is compensated are returned to the venture fund for further investment. Additionally, the Government expects, after some period of years, the Corporation may receive revenues which will permit it to be self-sustaining for both the management activities of the Corporation and future investing and grant activity.

**D. OnPoint Board of Trustees.** Once fully staffed, OnPoint will have a five person Board of Trustees. Two members were named by MILCOM. The other three members are suggested by MILCOM, but require Army approval prior to appointment to the Board. There are currently four persons named to the OnPoint Board of Trustees. These are:

Michael Buffa – One of the founders of MILCOM and its current chief executive  
Jason Rottenberg - President of MILCOM  
Harkley Thornton - Attorney, entrepreneur and former Army officer  
Paul Gompers - Harvard professor and expert on corporate venture capital

**E. Streamlined Acquisition Procedures to Develop and Field Technologies Identified by OnPoint.** Improved collaboration between the Army and OnPoint is being managed through a series of workshops designed to provide OnPoint the information it needs to better identify technology opportunities of interest to the Army. These workshops will also provide OnPoint a forum for discussing technologies that it has identified with potential Army and Army contractor users. The first of these workshops was held on the 24<sup>th</sup> of June, 2003. They will continue on a periodic basis.